Minimum wage

A **minimum wage** is a wage rate established by collective bargaining or by government regulation that specifies the lowest rate at which labour may be employed. The rate may be defined in terms of the amount, period (i.e., hourly, weekly, monthly, etc.), and scope of coverage. For example, employers may be allowed to count tips received by employees as credits toward the mandated minimum-wage level.[1]

Effects of the minimum wage

A minimum wage law is compulsory unemployment. The law says: it is illegal, and therefore criminal, for anyone to hire anyone else below the level of X dollars an hour. This means, plainly and simply, that a large number of free and voluntary wage contracts are now outlawed and hence that there will be a large amount of unemployment. The minimum wage law provides no jobs; it only outlaws them; and outlawed jobs are the inevitable result.[2]

A **minimum wage** leads to a reduction in the demand for labor and an increase in the supply of labor in the relevant market — usually, the market for low-skill workers. It removes the ability of some workers to compete by accepting lower wages and shuts them out of the labor force. As a result, it reduces job opportunities for these workers.

But there are additional, hidden costs of these interventions, which are more difficult to detect but perhaps more insidious. For example, one effect of a minimum wage is to reduce the availability of on-the-job training, since more resources are required simply to hire and retain a workforce. And further interventions in the labor market (for example, safety regulations and payroll taxes) make it still more costly to employ labor. These burdens together reduce a firm's willingness to hire laborers and — in the long run — must reduce the number of opportunities for those laborers to acquire valuable job skills. Far from increasing opportunities for the working poor, a minimum wage actually restricts their mobility.

Firms faced with minimum wage laws often substitute skilled for unskilled labor. A report from the Show-Me Institute offers an illustrative example: Suppose that a job can be done by either three unskilled workers or two skilled workers. If the unskilled wage is $5 per hour and the skilled wage is $8 per hour, the firm will use unskilled labor and produce the output at a cost of $15. However, if we impose a minimum wage of $6 per hour, the firm will instead use two skilled workers and produce for $16 as opposed to the $18 cost of using unskilled workers. In the "official data" this shows up as a small job loss — in this case, only one job — but we see an increase in average wages to eight dollars per hour in spite of the fact that the least skilled workers are now unemployed.

There is also a hidden social cost in minimum wage policies. Debates over a minimum wage erode social fabric by placing workers and their employers in opposition to one another. While there have been many legitimate reasons for some tension to exist between firms and workers, minimum wage policies set them in unnecessary opposition to one another over employment contracts, which are by nature cooperative and mutually beneficial. Encouraging the view that employment is a raw deal has created needless acrimony. At the margin, this intimidates people and discourages some from becoming employers themselves.

The prohibition of certain kinds of labor contracts also discriminates against — paradoxically — the law-abiding. Just as legal prohibitions on the use and sale of drugs have lured the lawless into the drug trade, prohibitions on certain forms of labor ensure that only those lacking in scruples will be left on the demand side of the market for, say, child labor and the like.

If restrictions, regulations, and price floors create massive deadweight losses, they also create incentives for firms and individuals to evade those restrictions, regulations, and price floors. Those with a comparative advantage in evading (or violating) the law will be most successful; thus, labor market regulation gives implicit encouragement and support to the unscrupulous. Restriction and regulation reduces the relative price of dishonesty, which means we can expect greater levels of it in the marketplace.[3]

Effects on minorities

Minimum wage is especially harmful for minorities. According to a study of two labor economists, Professors William Even (Miami University of Ohio) and David Macpherson (Trinity University), each 10 percent increase in a federal or state minimum wage decreased employment of white males by 2.5 percent; for Hispanic males, the figure is 1.2 percent. But among black males in this group, each 10 percent increase in the minimum wage decreased employment by 6.5 percent. The effect is similar for hours worked: each 10 percent increase reduced hours worked by 3 percent among white males, 1.7 percent for Hispanic males, and by 6.6 percent for black males. The consequences of the minimum wage for the last subgroup were even more harmful than the consequences of the recession.[4]

Although outright racism has often been blamed as the sole cause of heavy minority teenage unemployment, it is clearly not the only factor. In the late 1940's and early 1950's, young blacks had a lower unemployment rate than did whites of the same age group. But after the minimum wage increased significantly, especially in 1961, the black youth unemployment rate has increased to the extent that in 1980s it was a multiple of the white youth unemployment rate.

To make the case that racism itself is the cause of the employment and unemployment disparity among blacks and whites, one would have to claim that America was more racially harmonious in the past than it is now. In fact, during the racially hostile times of the early 1900s 71 percent of blacks over nine years of age were employed, as compared with 51 percent for whites. The minimum wage means that employers are not free to decide among low-wage workers on the basis of price differentials; hence, they face fewer disincentives to deciding according to some other (possibly racial) criteria.

To see the racial implications of minimum wage legislation, it is helpful to look at proponents of the law in a country where racial hostility is very strong, as in 1980s South Africa. Since minimum wage laws share characteristics in common with equal pay laws, white racist unions in South Africa continually supported both minimum wage and equal-pay-for-equal-work laws for blacks.

The reason for restlessness of white trade unions in South Africa was a $1.52-per-hour wage differential between black and white construction workers. Although the owners of the construction firms were white, they could not afford to restrict employment to whites when blacks were willing to work for $1.52 per hour less. As minimum wages eliminated the wage differential, the cost to employers of hiring workers with the skin color they preferred was reduced. As the cost of discrimination falls, and with all else remaining the same, the law of demand would dictate that more discrimination in employment practices will occur.

Markets frequently respond where they can, even to the obstacles the minimum wage presents minority groups. In fact, during the NRA blacks would frequently be advanced to the higher rank of "executives" in order to receive exemptions from the minimum wage. The free market demands that firms remain color-blind in the conduct of business: profit, not racial preference, is the primary concern of the profit-maximizing firm. Those firms who fail the profit test get driven out of business by those who put prejudice aside to maximize profits.

When markets are restricted by such laws as the minimum wage, the prospects for eliminating racial discrimination in hiring practices and the shocking rate of black teenage unemployment in American cities are bleak.

Example from Puerto Rico

In 1938, the federal government set the first U.S. minimum wage at 25 cents per hour. At the time, the average wage in the United States was 62.7 cents per hour, so most workers were unaffected. However, the law also applied to Puerto Rico, which was poorer and underdeveloped relative to the United States. Many workers in Puerto Rico earned only 3 to 4 cents per hour at the time. The result of the minimum wage was massive business bankruptcy and high unemployment.[5]

The Roosevelt administration created the federal minimum wage with passing of the Fair Labor Standards Act (FLSA). The act was notably supported by labor unions, which faced its fiercest competition from nonunion garment factories in the southern United States and in Puerto Rico. Subject to the same national rate as workers on the mainland, Puerto Rican workers suffered much more hardship from the minimum wage law. "...the framers of the law apparently forgot about Puerto Rico, and very grave disturbances came in that island."

When the Congress established a minimum wage of 25 cents per hour in 1938, the average hourly wage in the U.S. was 62.7 cents. It resulted in a mandatory increase for only some 300,000 workers out of a labor Force of more than 54 million. In Puerto Rico, in contrast, the new Federal minimum far exceeded the prevailing average hourly wage of the major portion of Puerto Rican workers.

Puerto Rico's unemployment rate rose sharply due to the Fair Labor Standards Act. Tens of thousands lost their jobs in such industries as cigar and cigarette manufacturing, which all but disappeared. The needlework industry, which employed over 40,000 workers in 1935, stagnated after the new act took effect. The value of needle-trade exports fell from over $20 million before the act in 1937 to barely $5 million in 1940.

After two years of economic disruption in Puerto Rico, Congress amended the minimum wage provisions. The minimum wage was reduced to 12.5 cents per hour, but it was too late for many industries and for thousands of low-wage earners employed by them, who suddenly found unemployment the price they had to pay for the minimum wage. In sum, the tragedy of the minimum wage laws was not just textbook-theorizing by academic economists, but real-world disaster for the thousands who became the victims of the law. But these destructive effects have not caused the law to be repealed; to the contrary, it has been expanded in coverage and increased in amount.[]

The Congress passed a separate amendment that established committees in some forty industries to set separate industry and occupational minima. From 1940 until 1974, amendments to the FLSA expanded coverage on the island but maintained the industry-committee mode of setting minima. With the 1974 and 1977 Amendments to the FLSA, however, Congress introduced a new policy, increasing coverage and enacting automatic increases in Puerto Rican minima to bring them to the U.S. level. The 1977 Amendment required industries with minima at U.S. levels to follow the scheduled mainland increases and those whose minima were below U.S. levels to increase wages by $0.30 per year until they reached the federal minimum. By 1983, Puerto Rico had effectively reached the mainland minimum wage.

The imposition of the U.S.-level minimum wage to Puerto Rico distorted the Puerto Rican earnings distribution, substantially reduced employment on the island (estimated at 8-10 percent), reallocated labor across industries, and affected the characteristics of migrants to the United States. ("Migrants from Puerto Rico to the United States are drawn largely from persons jobless on the island, with characteristics that make them liable to have been disemployed by the minimum wage.")[6]

Empirical research

For many years it has been a matter of conventional wisdom among economists that the minimum wage causes fewer jobs to exist than would be the case without it. This is simply a matter of price theory, taught in every economics textbook, requiring no elaborate analysis to justify. Were this not the case, there would be no logical reason why the minimum wage could not be set at $10, $100, or $1 million per hour.

Historically, defenders of the minimum wage have not disputed the disemployment effects of the minimum wage, but argued that on balance the working poor were better off. In other words, the higher incomes of those with jobs offset the lower incomes of those without jobs, as a result of the minimum wage

This notion was disputed by the work of three economists: David Card and Alan Krueger of Princeton, and Lawrence Katz of Harvard. Their studies of increases in the minimum wage in California, Texas and New Jersey found no loss of jobs among fast food restaurants that were surveyed before and after the increase. This led the Clinton Administration to advance the theory that modest increases in the minimum wage will have no impact on

employment.

However, an extensive body of work demonstrates a different conclusion. Joint Economic Committee Republicans published a survey of virtually every empirical study on the minimum wage in February, 1995. It concluded that a 10% increase in the minimum wage reduced teenage employment by 1% to 3%.

It also indicated that the minimum wage has wide-ranging negative effects that go beyond unemployment. For example, higher minimum wages encourage employers to cut back on training, thus depriving low wage workers of an important means of long-term advancement, in return for a small increase in current income. For many workers this is a very bad trade-off.[7]

Support for the minimum wage

Unions are labor cartels that attempt to restrict the supply of workers entering given occupations. Since non-union labor is priced below the cartelized price of union labor, it is an attractive substitute for union workers. Because unionization of all potential competition to the cartel is impossible due to the high policing costs that would be involved, unions resort to the minimum wage. By artificially increasing the wage rate of lower-skilled workers — who could substitute for union workers — the minimum wage increases the demand for union workers and hence their wage rates. Thus, government enforcement of a minimum wage allows unions to (1) keep a stronger cartel, raising their income; (2) incur no policing costs; and (3) have the government force low-skilled, nonunion workers out of the labor market. Thus, unions everywhere support the minimum wage.

Trade unions are highly organized institutions, and they do not take lightly the benefits that accrue to them through minimum wage laws. At their disposal are large numbers of highly organized voting members, as well as considerable financial/political clout.

The greatest concentration of benefits would, a priori, be thought to accrue to unions in such occupations as apparel, textiles, and agriculture, where direct competition with nonunion workers is greatest. And indeed, these are the unions we actually see consistently lobbying for higher minimum wages. It is clear that unions have no intention of improving the lot of poorer workers through the minimum wage law.

It may seem strange that business would push for a higher minimum wage. On examination, however, it is found that some businesses have the same motives for supporting the minimum wage as have labor unions. The economic self-interest of businesses that pay above the minimum wage dictates that they try to eliminate lower-cost rivals that pay below the minimum by forcing them to pay higher wage rates. That this is the case can be seen as far back as the time of the NRA codes.

Businesses like the minimum wage for the same reason they like tariffs — to shut out lower-priced firms from free market competition. The minimum wage becomes a mechanism by which firms with high labor costs can force higher labor costs on their lower-cost competition. What makes it so seductive for businesses is that it can effectively close down their rivals, increase their incomes, and enable them to claim "social responsibility and business morality" in the process.

The tragedy of the minimum wage is not only the black teenage unemployment rates in American large cities, but that many drop out of the labor force altogether to become another poverty statistic or turn to criminal activity. If frustrated workers can end up as recipients of the generous welfare state, they may decide that receiving welfare is better than working productively. Minimum wages may therefore be a technique of lowering the costs of, establishing eligibility for the increasingly generous public welfare programs. Minimum wages induce welfare, not work.

In this case, the disemployed workers who receive welfare are not the only vested interests; social workers, and the entire "poverty industry" also benefit. If there are more poor because of the minimum wage, the demand for people to manage and take care of the poor also increases. There is little incentive for social workers or poverty rights activists to advocate the repeal of the law that keeps them employed.

Politicians who "champion" a large poverty class are beneficiaries of the minimum wage as well. Since the law cuts off the first necessary condition for upward mobility (first-time employment), a permanent supporting constituency is preserved. A powerful triangle then emerges among the "poverty politician," social workers, and welfare recipients. Politicians who claim to represent the working poor can raise the minimum wage, throwing low-wage earners out of work. The modern welfare state can pick them up and provide them with greater benefits than what they could receive by working. Welfare recipients reward the politicians by voting for them, and the social workers and welfare bureaucrats find the demandfor their services increased, entrenching their jobs. Each group in the political triangle of the minimum wage tends to benefit at the expense of the general taxpayer and the relatively low-skilled worker.

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